

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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APR 14 1995

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify under that section.

You were incorporated under the laws of [REDACTED] on [REDACTED]. Your purposes as stated in your articles of incorporation are "exclusively religious, charitable, scientific, literary, and educational within the meaning of the Internal Revenue Code of 1986 or the corresponding provision of any future United States Internal Revenue law." Your articles otherwise satisfy the organizational test of section 501(c)(3).

Your bylaws further expand on your purposes and provide that you propose to:

- (a) Establish and maintain health care facilities for the care of persons suffering from illnesses or disabilities which require that the patient receive in or out patient care;
- (b) Carry on any educational activity designed to promote the general [REDACTED] of the community;
- (c) Carry on any educational activities related to rendering care to the sick and injured or the promotion of health;
- (d) Carry on scientific research and, to acquire real estate for the ultimate purpose of constructing, equipping, operating and maintaining one or more hospitals and/or clinics.

Your predecessor organization was a partnership called [REDACTED]. The partners were [REDACTED], M.D., P.A., [REDACTED], M.D. and [REDACTED], M.D., P.A. [REDACTED] and [REDACTED] retired, leaving [REDACTED] as the only active

partner. [REDACTED] was bought out by [REDACTED] and [REDACTED]'s P.A. partnership interest was liquidated by the partnership in [REDACTED].

The partnership's role was to provide the three physicians with an entity to practice medicine to maximize their income. Each physician was allocated income in relationship to his cash collections. All available cash over necessary operating capital was withdrawn by the partners. Ultimately, it was anticipated that they would sell their interest to a new physician.

No assets or liabilities of the predecessor corporation or partnership were assumed by you. All property, plant and equipment owned by the predecessor partnership are being used by you. There are no written agreements relating to the use or sale of this equipment. It is anticipated that the predecessor partnership will either donate or sell such assets to you.

You state that your purpose is to provide a comprehensive medical and general health care clinic for residents of [REDACTED], [REDACTED] and surrounding areas. The physicians who staff the clinic, [REDACTED], M.D., [REDACTED], M.D., and [REDACTED], M.D., will also staff [REDACTED], a non-profit hospital operated by [REDACTED].

Your current governing body is made up of two members of the [REDACTED] board, [REDACTED], M.D., who is chairman of both boards, and [REDACTED], Administrator of [REDACTED]. [REDACTED] is the primary physician of the clinic and is very much involved in its day to day operations.

You state that there are only three physicians currently practicing in [REDACTED], all of whom work for you. Two of those three are on the staff of [REDACTED].

You state that most of your patients are covered by Medicare or Medicaid. You do not provide care to the indigent, or to persons otherwise unable to pay directly or through third-party reimbursement. You state that you have no educational or medical research programs.

Until [REDACTED], the clinic operated as a partnership, on a for-profit basis. The partnership operated at a loss for the year ending [REDACTED].

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for one or more of the purposes specified therein, no part of the net earnings of which inures to the benefit of a private shareholder or individual.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational," as used in section 501(c)(3) of the Code, relates to the instruction of the public on subjects useful to the individual and beneficial to the community. An example of an educational organization described in the regulations is one whose activities include public discussions, forums, lectures, panels and other similar programs. Such programs may be on radio or television.

Rev. Rul. 69-545, 1969-2 C.B. 117 provides two situations to illustrate whether a nonprofit hospital claiming exemption under section 501(c)(3) of the Code is operated to serve a public rather than a private interest; Revenue Ruling 56-185 modified.

In Situation 1, the ruling found that by operating an emergency room open to all persons and by providing hospital care for all those persons in the community able to pay the cost thereof either directly or through third party reimbursement, the hospital in this situation was promoting the health of a class of

persons that was broad enough to benefit the community. The ruling also noted that control of the hospital rested in its board of trustees, which was composed of independent civic leaders. Thus, a community benefit was evident and the hospital in this situation would qualify for exemption under section 501(c)(3).

In Situation 2, the hospital was a 60-bed general hospital which was originally owned by five doctors. The owners formed a nonprofit organization and sold their interests in the hospital to the organization at fair market value. The board of trustees of the organization consisted of the five doctors, their accountant, and their lawyer. The five doctors also comprised the hospital's medical committee and thereby controlled the selection and the admission of other doctors to the medical staff. During its first five years of operations, only four other doctors were granted staff privileges at the hospital. The applications of a number of qualified doctors in the community had been rejected. Hospital admission was restricted to patients of doctors holding staff privileges. Patients of the five original physicians accounted for a large majority of all hospital admissions over the years. The hospital maintained an emergency room, but on a relatively inactive basis, and primarily for the convenience of the patients of the staff doctors. The local ambulance services were instructed by the hospital to take emergency cases to other hospitals in the area. The hospital followed the policy of ordinarily limiting admissions to those who can pay the cost of the services rendered. The five doctors comprising the original medical staff continued to maintain their offices in the hospital since its sale to the nonprofit organization. The rental paid was less than that of comparable office space in the vicinity. No office space was available for any of the other staff members. Although its ownership had been transferred to a non-profit organization, the hospital had continued to operate for the private benefit of its original owners who exercised control over the hospital through the board of trustees and the medical committee. They used their control to restrict the number of doctors admitted to the medical staff, to enter into favorable rental agreements with th-

hospital, and to limit emergency room care and hospital admission substantially to their own patients. These facts indicated that the hospital was operated for the private benefit of its original owners, rather than for the exclusive benefit of the public. See, Sonora Community Hospital v. Commissioner, 46 T.C. 519 (1966), aff'd. 397 F.2d 814 (1968). Accordingly, it was found that the hospital in this case was serving private as opposed to public interests and therefore could not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 83-157, 1983-2 C.B. 94, provides that a nonprofit hospital that is not required to operate an emergency room where a state or local health planning agency has found that this would unnecessarily duplicate emergency services and facilities that are adequately provided by another medical institution in the community is exempt under section 501(c)(3) of the Code. Rev. Rul. 69-545 amplified.

An organization is not operated exclusively for charitable purposes, and thus will not qualify for exemption under section 501(c)(3), if it has a single non-charitable purpose that is substantial in nature. This is true regardless of the number or importance of the organization's charitable purposes. Better Business Bureau v. United States, 326 U.S. 278 (1945); Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (8th Cir. 1963), aff'g. 39 T.C. 93 (1962), Cert. denied, 376 U.S. 969 (1964). Operating for the benefit of private parties who are not members of a charitable class constitutes such a substantial nonexempt purpose. Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), cert. denied, 413 U.S. 910 (1973).

You were originally a for-profit medical practice, operating for the pecuniary gain of your owners, which you state "operated at a loss for the years ending [redacted] and [redacted]." as such, you delivered health care to the general public. Other than providing salaries to your physicians, your present operations as a nonprofit corporation do not appear to have changed in any significant way and cannot be distinguished from your proprietary operations.

Further, other than a lease agreement for a telephone system, you have stated that you do not have any written agreements with related persons or entities, thus making it

impossible to delineate the separate and distinct legal obligations of the partnership, the clinic, the hospital and the original owners of the for-profit entity in everyday operations.

While you may provide health care services, you do not provide such services in a charitable manner within the meaning of section 501(c)(3) of the Code because you do not meet the community benefit standard set forth in Rev. Rul. 69-545, supra. Unlike Hospital A, in Situation 1 of the ruling, you have no full time emergency room in which indigent care is provided, you conduct no research or educational programs, and you conduct no medical training. In this respect you cannot be distinguished from an ordinary for-profit medical clinic.

Like Hospital B, in Situation 2, you are essentially the continuation of a pre-existing proprietary medical practice. And like that organization, access to your medical staff is restricted, you do not operate an emergency room open to the public, and you do not provide indigent care. While Rev. Rul. 82-157, supra., does not absolutely require the operation of an emergency room, the exception set forth in that ruling is limited to circumstances where an appropriate government authority has made a determination that the operation of an emergency room is unnecessary. The Service position is that a hospital or clinic must make a substantial showing of community benefit to distinguish it from organizations carrying on the ordinary practice of medicine on a for-profit basis. You have not made such a showing.

You do not meet the community benefit standard set out in Rev. Rul. 69-545, supra, and you have not otherwise established that you are operated exclusively for charitable purposes. Because you do not have the primary purpose of benefitting the community, your operations are indistinguishable from those of an organization engaged in the practice of medicine on a for-profit basis. As such, you serve private rather than public interests. Therefore, we can not recognize you as an organization exempt under section 501(c)(3) of the Code.

Contributions to you are not deductible under section 170 of the Code.

You are required to file federal income tax returns. you have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your

[REDACTED]

views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

(signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Technical Branch 3

cc: DD, Atlanta
Attn: EO Group

cc: w/Form 5998
State Officials of [REDACTED]